

Internal Revenue Service
memorandum

WHEARD CC:TL:TS
TL-N-2303-90

date: MAR 28 1990

to: Brooklyn District Counsel CC:BRK
Attn: Nancy Rothbaum

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]

TL-N-2303-90 Non-docketed
CC:TL:TS Heard Wilson
I.R.C. §§ 6231(a)(3), 6231(a)(4), 6231(a)(5)
Currency Conversion Loss as Non-partnership Item

This memorandum is in response to your request for technical advice which was received by this office on December 29, 1989.

ISSUE

Whether foreign currency conversion losses claimed by a U.S. taxpayer in its [REDACTED] and [REDACTED] fiscal tax returns, calculated on the book value in British pounds of its investment in a foreign partnership and the decline of the pound against the dollar, are nonpartnership items.

CONCLUSION

The foreign currency conversion loss should be treated as a nonpartnership item subject to normal deficiency procedures.

FACTS

[REDACTED] (" [REDACTED] ") is a foreign partnership based in England. It has two partners, a foreign corporation and a U.S. corporation. The U.S. corporation is [REDACTED]. For its [REDACTED] and [REDACTED] taxable years, [REDACTED] claimed deductions for foreign currency conversion losses pursuant to its interest in [REDACTED] in the amounts of \$ [REDACTED] and \$ [REDACTED]. [REDACTED] claimed entitlement to such losses based on the decline of the value of the British pound against the dollar even though no event occurred which would trigger recognition of a loss. [REDACTED] simply converted the values on the partnership balance sheet from pounds to dollars and the decline in value in dollars was reported as a loss.

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Partnership items were previously settled through a Form 870-P. The currency conversion loss was not picked up in the settlement agreement which only addressed issues arising on the partnership return. More than one year has passed since the execution of the Form 870-P.

DISCUSSION

Initially we note that section 404 of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) makes foreign based partnerships subject to the filing requirements of I.R.C. § 6031 if they have any United States partners. 26 U.S.C. 6031. Section 6231(a)(1)(A), in turn, makes TEFRA applicable to all partnerships (except "small" partnerships) required to file a return pursuant to section 6031(a). Thus, Congress intended that foreign based partnerships with any United States partners be¹ subject to the unified partnership level proceedings of TEFRA.

Section 6231(a) provides as relevant here:

(3) **Partnership item.**—The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

¹ In this regard, the Conference Committee report on the TEFRA provisions provides:

The bill explicitly applies the partnership filing requirements under section 6031 to any partnership which has U.S. partners (direct or indirect). Where the TMP resides outside the United States or the partnership books and records are kept outside the United States, failure to comply with the partnership return requirement or provide the return information upon request will result in disallowance of partnership losses and credits to the partners.

Tax Equity and Fiscal Responsibility Act of 1982, H. Rept. 97-760 (conf.) (1982), 1982-2 C.B. 600. See also I.R.C. § 6231(f) (treatment of foreign based partnerships).

(4) Nonpartnership item.—The term "nonpartnership item" means an item which is (or is treated as) not a partnership item.

(5) Affected item.—The term "affected item" means any item to the extent such item is affected by a partnership item.

TEFRA was enacted so that partnership items, i.e., items required to be taken into account for the partnership's taxable year under subtitle A, would be determined in a unified proceeding at the partnership level. See I.R.C. § 6221; Conference Committee Report on P.L. 97-248. Once partnership items are determined at the partnership level, affected items, including penalties, additions to tax, and partner level determinations affecting the amount of partnership items flowing through to a partner may be determined. N.C.F. Energy Partners v. Commissioner, 89 T.C. 741 (1987); Temp. Treas. Reg. § 301.6231(a)(5)-1T; Temp. Treas. Reg. § 301.6231(a)(6)-1T. If the partner level determination is not merely computational based on the outcome of the partnership proceeding, any deficiency attributable to the partner level determination must be raised through an affected item notice of deficiency. I.R.C. § 6230(a); N.C.F. Energy Partners v. Commissioner, supra.

Statutorily, the definition of an affected item and nonpartnership item overlap. Any item which is not a partnership item is a nonpartnership item. I.R.C. § 6231(a)(4). Section 6231(a)(5) provides, however, that any item which is affected by a partnership item is an "affected item". Affected items are subject to the period of assessment for partnership items. I.R.C. § 6229(a). Nonpartnership items are subject to the periods for assessment under section 6501 or section 6229(f). See Litigation Guideline Memorandum, TL-81. Whether a currency conversion loss is an affected item or nonpartnership item, it will be subject to deficiency procedures. The determination of whether it should be treated as a nonpartnership item or affected item, however, will affect the timing of the issuance of the notice (whether it must await the outcome of a TEFRA proceeding) and the determination of the period for assessment.

Initially we note that the currency conversion loss by [REDACTED] is not a partnership item because it is not "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A". Treas. Reg. § 301.6231(a)(3)-1 defines such items as items of income, deduction, credits, distributions, etc. which are determined at the partnership level and flow through to the investors. Both the partnership and the other partner are English and, thus, could take no similar conversion loss at the partnership or partner level for the devaluation of partnership interests against the dollar (assuming no investment in U.S. assets) even

if a recognition event had occurred. Since the conversion loss is not a partnership level determination which flows through to the partners, it does not fall within the definition of a partnership item.

Arguably, the conversion loss could be construed as an affected item since it was computed based on the value of the investment in the partnership reported on the partnership balance sheet. The amount of [REDACTED]'s outstanding balance in its partnership interest is a partnership item because it is composed of [REDACTED]'s initial contribution as adjusted by [REDACTED]'s allocable share of partnership items. See Treas. Reg. § 6231(a)(3)-1(a) (amount of contributions to and distributions from partnership, and items of income, deductions, etc. of a partnership are partnership items); I.R.C. § 1016 (adjustments to basis include allocable share of partnership items). Thus, in some sense, the currency loss taken is affected by the amount of a partnership item.

However, the amount of this balance in [REDACTED]'s investment is not subject to dispute and the Service does not seek to adjust this amount. The deficiency the Service wishes to assert is solely attributable to a factor outside of the partnership and partner which does not affect the determination of the amount of a partnership item at the partnership level, nor affects the amount of that item which will flow through to the partner (such as an affected item basis or at risk determination).

Although there is some relation between the amount of the investment and the amount of the loss being taken, it is our position that the loss neither constitutes a partnership item nor an affected item as contemplated by the TEFRA provisions. Thus, it should be treated as a nonpartnership item and a notice of deficiency may be issued as long as the period for assessment under section 6501 remains open.


Even if the currency loss were considered an affected item, a notice of deficiency may be issued as long as the period for assessment remains open. The Form 870-P converted the partnership and affected items of [REDACTED] to nonpartnership items. See I.R.C. § 6231(b)(1)(C). Pursuant to section 6229(f), the period for assessing converted affected items "shall not expire before the date which is one year after the date on which the items become nonpartnership items." It is unresolved whether the Service will also have the benefit of the period for assessment under section 6501 for nonpartnership items if this period is longer than the period for assessing converted items under section 6229(f). In the appropriate factual circumstances,

the Service will argue that the government has the benefit of being able to assess under whichever of the two periods is longer. See Litigation Guideline Memorandum, supra.

Since it is our position that the currency loss was always a nonpartnership item, the only applicable period for assessment is section 6501. We would raise the alternative argument that section 6501 also applies to converted partnership and affected items (in addition to section 6229(f)) only as an alternative position given the hazard that a court may find the conversion loss to be an affected item. If this argument becomes necessary, it should first be coordinated with this office.

Please refer any questions on this matter to Bill heard at FTS 566-3289.

MARLENE GROSS

By: 
CURTIS G. WILSON
Acting Branch Chief
Tax Shelter Branch

Attached:
Incoming Inquiry.